VERMONT UNIVERSAL

SERVICE FUND

FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2013 AND 2012

WF&D

WAGGONER, FRUTIGER & DAUB, LLP

CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITORS' REPORT

To the Vermont Public Service Board and the Administrator
of the Vermont Universal Service Fund:

Report on the Financial Statements

We have audited the accompanying statements of net position of the Vermont Universal Service Fund (VUSF), a special reserve fund of the State of Vermont, as of June 30, 2013 and 2012 and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of VUSF as of June 30, 2013 and 2012, and the respective change in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting Principle
As discussed in Note 2f to the financial statements, in 2012 the Fund adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.* Our opinion is not modified with respect to this matter.

Other Matters
Required Supplementary Information
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on page 3 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*
In accordance with *Government Auditing Standards,* we have also issued our report dated November 7, 2013 on our consideration of VUSF's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering VUSF's internal control over financial reporting and compliance.

Waggoner Frutiger + Daub LLP

Mechanicsburg, Pennsylvania
November 7, 2013

VERMONT UNIVERSAL SERVICE FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS

Years Ending June 30, 2012 and 2013

This section of the Vermont Universal Service Fund's annual financial report represents our discussion and analysis of the VTUSF's financial performance during the fiscal years that ended on June 30, 2012 and June 30, 2013. It should be read in conjunction with the VTUSF's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The VTUSF total current assets as of June 30, 2012 were $2,617,241 and were $2,175,982 as of June 30, 2013.
- The VTUSF total current liabilities as of June 30, 2012 were $138,210 and $209,101 as of June 30, 2013.
- The VTUSF unrestricted net assets as of June 30, 2012 were $2,479,031 and $1,966,881 as of June 30, 2013.
- The VTUSF operating revenue for the year ended June 30, 2012 was $5,876,273 and $6,619,045 for the year ended June 30, 2013.
- Non-operating revenue for the year ended June 30, 2012 was $288 and $151 for the year ended June 30, 2013.
- The VTUSF total operating expense for the year ended June 30, 2012 was $7,181,010 and $7,131,346 for the year ended June 30, 2013.
- The VTUSF program expense for the year ended June 30, 2012 was $7,088,510 and $6,963,346 for the year ended June 30, 2013.
- Administrative cost for the year ended June 30, 2012 was $92,500 and $168,000 for the year ended June 30, 2013.
- The VTUSF overall change in assets for the year ended June 30, 2012 was a decrease of $1,304,449 from $3,783,480 at the beginning of the year to $2,479,031 at the end of the year. Assets during 2013 decreased by $512,150 to $1,966,881.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of two parts – management's discussion and analysis and the basic financial statements. The basic financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

Total VTUSF contributions for the year ended June 30, 2012 were $5,414,474 and were $6,251,682 for the year ended June 30, 2013. Total VTUSF distributions to service providers for the year ended June 30, 2012 were $6,225,886 and were $5,322,510 for the year ended June 30, 2013. Performance Assurance Plan ("PAP") revenues were received in the amount of $459,204 during 2012, and $366,114 during 2013.

Eligible service providers also claimed $72,003 in Lifeline administrative expenses and provided Lifeline credits to customers of $790,621 for the year ended June 30, 2012[1]. Claimed Lifeline Administrative expenses by eligible service providers were $50,005 and Lifeline credits to customers were $835,087 for the year ended June 30, 2013.

Cash and short term investments at the beginning of the 2012 year were $3,383,849. Cash and cash equivalents at year end June 30, 2012 were $2,077,020, a decrease in cash, cash equivalents and short term investments of $1,306,829, which is approximately 38.6%. Cash and short term investments during 2013 decreased $496,894. Cash and cash equivalents at year end June 30, 2013 were $1,580,126, which was a decrease in cash and cash equivalents and short term investments of 23.9%.

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[1] See Vermont Universal Service Fund Statements of Revenues, Expenses and Changes in Net Assets, Years Ended June 30, 2013 and 2012.

VERMONT UNIVERSAL SERVICE FUND
STATEMENTS OF NET POSITION
JUNE 30, 2013 AND 2012

ASSETS

		2013	2012
CURRENT ASSETS			
Cash and cash equivalents	$	1,580,126	2,077,020
Receivable from contributors		595,845	540,204
Interest receivable		11	17
Total current assets	$	2,175,982	2,617,241

LIABILITIES AND NET POSITION

		2013	2012
CURRENT LIABILITIES			
Payable to service providers	$	131,255	64,512
Payable to contributors - lifeline assistance		67,358	64,119
Payable to contributors - lifeline administrative expenses		3,193	1,165
Payable to contributors		7,295	8,414
Total current liabilities		209,101	138,210
NET POSITION			
Unrestricted		1,966,881	2,479,031
Total liabilities and net position	$	2,175,982	2,617,241

See accompanying notes.

VERMONT UNIVERSAL SERVICE FUND
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012

	2013	2012
OPERATING REVENUES		
Assessments	$ 6,251,682	5,414,474
Performance assurance plan penalty	366,114	459,204
Late payment charges	1,168	2,487
Miscellaneous income	81	108
Total operating revenues	6,619,045	5,876,273
OPERATING EXPENSES		
Program expenses		
Amounts paid and due to service providers	5,322,510	6,225,886
Lifeline administration	50,005	72,003
Lifeline credits	835,087	790,621
S180 payments to local exchange carriers	755,744	--
Total program expenses	6,963,346	7,088,510
Administrative costs	168,000	92,500
Total operating expenses	7,131,346	7,181,010
Operating loss	(512,301)	(1,304,737)
NON-OPERATING REVENUES		
Interest income	151	288
Total non-operating revenues	151	288
Decrease in net position	(512,150)	(1,304,449)
NET POSITION , BEGINNING OF YEAR	2,479,031	3,783,480
NET POSITION, END OF YEAR	$ 1,966,881	2,479,031

See accompanying notes.

VERMONT UNIVERSAL SERVICE FUND
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012

		2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES			
Receipts from telecommunication carriers	$	6,134,025	5,358,280
Performance assurance plan penalty		427,010	509,798
Late payment charges		1,168	2,487
Receipts from miscellaneous income		81	108
Payments for telecommunication programs		(5,255,767)	(6,217,764)
Payment for lifeline administration		(47,977)	(72,019)
Payment for lifeline credit		(831,848)	(795,516)
Payment for S180		(755,744)	--
Cash paid for administrative costs		(168,000)	(92,500)
Net cash used by operating activities		(497,052)	(1,307,126)
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest received		158	297
Net cash provided by investing activities		158	297
Net decrease in cash and cash equivalents		(496,894)	(1,306,829)
CASH AND CASH EQUIVALENTS-BEGINNING OF YEAR		2,077,020	3,383,849
CASH AND CASH EQUIVALENTS-END OF YEAR	$	1,580,126	2,077,020

RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES

		2013	2012
Operating loss	$	(512,301)	(1,304,737)
CHANGES IN ASSETS AND LIABILITIES			
(Increase) decrease in receivable from contributors		(55,641)	70,365
Increase in payable to service providers		66,742	8,123
Increase (decrease) in payable to contributors		4,148	(80,877)
Net cash used in operating activities	$	(497,052)	(1,307,126)

See accompanying notes.

VERMONT UNIVERSAL SERVICE FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 AND 2012

1. GENERAL

In 1994, the Vermont General Assembly passed a law ("Act 197") establishing the VUSF. The VUSF, which supports the Vermont Enhanced 911 ("E911"), Telecommunication Relay Services ("TRS"), Telecommunications Equipment Distribution and Lifeline Assistance programs, is supported by a Universal Service Fund assessment ("USF Assessment") on all retail telecommunications services provided to a Vermont address. The USF Assessment is collected by telecommunications service providers and paid, via a monthly remittance advice, to an administrator, who was selected by the Vermont Public Service Board ("VPSB") to act as fiscal agent of the VUSF.

The VUSF assessment rate was calculated by the VPSB after taking into consideration the projected funding requirements of the E911, TRS, Equipment Distribution, Lifeline Assistance programs, as well as administration expenses. The Order setting rate and Docket 7523(a) established the assessment rate of 1.35 percent of total retail telecommunications revenue for the period July 1, 2011 to August 31, 2011, an assessment rate of 1.60 percent of total retail telecommunications revenue for the period September 1, 2011 to August 31, 2012, and an assessment rate of 1.82 percent of total retail telecommunications revenue for the period September 1, 2012 to August 31, 2013.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Basis of Presentation
These statements have been prepared on the accrual basis in accordance with standards promulgated by the Governmental Accounting Standards Board ("GASB"), for the periods presented. Act 197 permits carriers to file their monthly remittances disclosing revenues on either a cash or accrual basis. The financial statement caption of "receivable from contributors" on the statements of net position, as well as the "assessments" on the statements of revenues, expenses and changes in net position are understated by an undeterminable amount for the difference of what is reported by the carriers reporting on a cash basis versus what would be reported by the carriers if they utilized the accrual basis. For the years ended June 30, 2013 and 2012, the VUSF had accounting transactions in unrestricted fund net position only. The VUSF's financial statement presentation follows the recommendation of GASB No. 34, "Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments" and amendments. GASB No. 34 as amended establishes financial reporting standards for the state and local governments and is effective for periods beginning after June 15, 2001, based on phase in dates as determined by annual revenues.

b. Cash and Cash Equivalents
All highly liquid securities, purchased with an original maturity of three months or less, are considered cash equivalents. Interest is credited to the VUSF when earned. The annualized investment rate was .01 percent for the years ended June 30, 2013 and 2012.

c. Use of Estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

d. Revenue Recognition
All Vermont telecommunication service providers are permitted to assess their customers based on usage at a statutory rate that is applied to interstate retail revenues. These assessments are then remitted to the VUSF. It is the VUSF's policy to recognize assessments, relating to the current fiscal year, received within two months after fiscal year end. Any late remittances will be recognized in the subsequent period or periods.

e. Income Taxes
These financial statements present the activities of the VUSF. The activities of the VUSF are tax-exempt since the VUSF is a special reserve fund of the State of Vermont, and therefore not subject to federal or state income taxes or sales, use, gross receipts or other taxes. As such, no provision for taxes has been reflected in the accompanying financial statements.

f. Change in Accounting Principle
During 2012, the VUSF adopted Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, where the consumption of net position by the government that is applicable to a future reporting period, and the acquisition of net position by the government that is applicable to a future reporting period are defined and identified distinctly from assets and liabilities, and the residual of all these elements is defined as net position rather than net assets. Other than reflecting net position, there was no other significant impact on the financial statements of the VUSF.

3. ASSESSMENTS

Assessments reflect the gross assessments for the year ended June 30, 2013 and 2012 which were $6,251,682 and $5,414,474 respectively. Assessments to the Fund represent identified carriers that are operating in the state of Vermont. The Administrator searches publicly available resources to identify carriers operating in the state of Vermont that are not contributing to the Fund. In addition, the VPSC notifies the Fiscal Agent when new carriers are certified to offer service in the state of Vermont. Once the carriers are identified, they are billed retroactively for all active periods of the VUSF in which they were operating in the state. The cumulative billings for prior periods, reporting of delinquent contributors and true-ups are out-of-period adjustments and are included in contributions in the period in which they are billed or determined. Out-of-period revenues included in contributions for the year ended June 30, 2013 and 2012 were not significant.

4. DISBURSEMENT TO VUSF PROGRAMS

Distributions to the State Treasurer of Vermont were made by the Administrator, as Fiscal Agent, for the years ended June 30, 2013, and 2012, as directed by the Vermont Public Service Board and Docket 7169, respectively. These directives require all TRS, Equipment Distribution, Outreach Services and E911 disbursements to be paid to the State Treasurer in amounts determined by the Vermont Department of Public Service. According to Act 197, Lifeline Assistance support payments are deducted from remittances by participating exchange carriers. Therefore, Lifeline Assistance amounts are considered paid when reported. The approximate amounts incurred by the Fund are as follows:

	2013	2012
Enhanced 911 board	$ 4,987,419	5,845,256
Telecommunications relay service	260,090	305,757
Equipment distribution	75,001	74,873
Total	5,322,510	6,225,886
Lifeline administration	50,005	72,003
Lifeline credits	835,087	790,621
S180 payments to local exchange carriers	755,744	--
Total program expenses	$ 6,963,346	7,088,510

5. ADMINISTRATIVE COSTS

As stated in the contract between the VPSB and the Administrator, the Administrator is reimbursed under a fixed amount each fiscal year plus any allowable variable costs, as defined. Such variable costs include any trips to Montpelier, Vermont, in excess of one time per year, and other reasonable and necessary expenses incurred by the Administrator in performance of services, including payments to an independent accountant for an annual audit, extraordinary legal work provided by external counsel and taxes, application fees, licensing fees, and similar expenses. Rolka Loube Saltzer Associates was the Administrator during the years ended June 30, 2013 and 2012. During the years ended June 30, 2013 and 2012, the administrative costs were as follows:

	2013	2012
Administrative fees	$ 78,000	78,000
S180 impact study	75,000	--
Audit fees	15,000	14,500
Total administrative costs	$ 168,000	92,500

6. CONCENTRATION OF CUSTODIAL CREDIT AND BUSINESS RISK

VUSF maintains its cash balances at Manufacturers and Traders Trust Company (M&T Bank). Cash balances at M&T Bank are invested in instruments issued or guaranteed as to principle and interest by the U.S. Government or any of its agencies or instrumentalities or in repurchase agreements backed by such instruments. Custodial credit risk is the risk that VUSF's deposits may not be recoverable to it in the event of a depository institution failure. VUSF does not have a formal policy regarding custodial credit risk for deposits. At June 30, 2013, VUSF had deposit balances in the amount of $1,580,126, of which $8,482 was insured and $1,571,644 was exposed to custodial credit risk.

Three service carriers account for approximately 55 percent and 59 percent of the VUSF's assessment revenue in 2013 and 2012, respectively. No other service carrier accounted for more than 10 percent of the VUSF's assessment revenue in 2013 and 2012. The Administrator estimates that substantially all of the VUSF accounts receivable will be collected based on the assessments issued and general economic conditions. Consequently, any adverse change in these factors could affect the Fund's estimate of bad debts.

7. PERFORMANCE ASSURANCE PLAN PENALTY

The Performance Assurance Plan (PAP) was established to measure a carrier's wholesale performance. As part of the acquisition of another carrier, the acquiring carrier agrees to comply with the PAP; the Board's Order approving the acquisition requires such compliance as a condition of approval. (Lackey pf. At 7; Docket No. 7270, Order of 2/15/08 at 54) PAP penalties are triggered because the acquiring carrier's wholesale service is either deficient relative to the standards in the PAP or discriminatory in favor of its own retail service. Fairpoint Communications has paid $366,114 in 2013 and $459,204 in 2012 for Mode of Entry (MOE) penalties under the PAP.

8. BILL S180 ESTABLISHING ONE YEAR HIGH COST FUND

In January of 2012, a bill was introduced and passed that created a one year high cost program under which the universal service charge shall be used as a means of keeping basic telecommunications service affordable in all parts of the state, thereby maintaining universal service. Payments shall be made to Vermont's Incumbent Local Exchange Carriers (ILECs) for the purpose of reducing the cost of providing basic local telecommunications service in areas where that cost would otherwise jeopardize universal service and uniform economic development. The bill ordered that any funds in excess of $1,000,000 remaining in the Vermont Universal Service Fund as of September 1, 2012, shall be distributed among all the ILECs in a manner determined by the commissioner of public service. On December 13, 2012, $755,744 was distributed among all the ILECs representing the excess funds over $1,000,000.

9. SUBSEQUENT EVENTS

VUSF has evaluated subsequent events through November 7, 2013, the date which the financial statements were available to be issued.

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To Vermont Public Service Board and the Administrator
of the Vermont Universal Service Fund:

We have audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Vermont Universal Service Fund (VUSF) as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, and have issued our report thereon dated November 7, 2013

Internal Control Over Financial Reporting
In planning and performing our audit of the financial statements, we considered VUSF's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of VUSF's internal control. Accordingly, we do not express an opinion on the effectiveness of VUSF's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies might exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *significant deficiency* is a deficiency or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the following deficiency to be a material weakness:

Financial statement preparation

Finding:
Although the Fund Administrator reviews the financial statements and disclosures and represents in writing that they are responsible for the fair presentation of the financial statements in conformity

Financial statement preparation (continued)

Finding (continued)
with generally accepted accounting principles (GAAP), numerous audit adjustments, both routine and non-routine in nature, were required to be posted to the VUSF's accounts to properly reflect the financial position and financial activity for the year under audit. The information for the adjustments was provided by the VUSF Fund Administrator but the information had not been analyzed and compiled as adjustments. The fact that the adjustments had not been posted and were required to be compiled and posted in order for the financial statements to be properly stated constitutes a deficiency in the VUSF's internal control over financial reporting processes and routine, non-routine and non-systematic transactions, that could potentially result in a material misrepresentation of the financial activity and financial position of the VUSF.

Response:
At this time management has determined that the cost of implementing a corrective action would be in excess of the benefit achieved. In the alternative, management has regularly consulted with Certified Public Accountants regarding record keeping and continually maintained both a database developed specifically for the administration of the Fund as well as a QuickBooks accounting program and regularly reconciles both systems with the independently maintained M&T Bank records.

Compliance and Other Matters
As part of obtaining reasonable assurance whether the Vermont Universal Service Fund's financial statements are free from material misstatement, we performed tests of compliance of the Fund Administrator for the Vermont Universal Service Fund (VUSF) with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Vermont Universal Service Fund's Response to Findings
VUSF's response to the findings identified in our audit are described above. VUSF's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report
The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

[illegible], LLP

Mechanicsburg, Pennsylvania
November 7, 2013